

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

BIG RIVERS ELECTRIC CORPORATION'S NOTICE)	
OF CHANGES IN RATES AND TARIFFS FOR)	CASE NO. 90-128
WHOLESALE ELECTRIC SERVICE)	

O R D E R

INTRODUCTION

On June 29, 1990, Big Rivers Electric Corporation ("Big Rivers") filed an application requesting authority to increase its electric rates for wholesale service rendered on and after August 1, 1990 to its four member distribution cooperatives. The rates proposed by Big Rivers would produce increased annual revenues of \$6,935,978, an increase of 2.6 percent over normalized revenues.

The Commission issued an Order Of Procedure, dated July 20, 1990, establishing dates for discovery and a hearing, and suspending Big Rivers' proposed rates for five months, until January 1, 1991, to conduct further proceedings to determine the reasonableness of the proposed rates. Intervention was requested by, and granted to, the Utility and Rate Intervention Division of the Office of Attorney General ("AG"), National-Southwire Aluminum Company ("NSA"), Alcan Aluminum Corporation ("Alcan"), Commonwealth Aluminum Corporation ("Commonwealth Aluminum"), Green River Electric Corporation ("Green River"), and Henderson-Union Rural Electric Cooperative Corporation ("Henderson-Union").

A hearing was held at the Commission's offices in Frankfort, Kentucky, on October 24, 1990, with all parties of record represented. Simultaneous briefs were filed on November 21, 1990, simultaneous reply briefs were filed on November 28, 1990, and all information requested during the hearing has been submitted.

COMMENTARY

Big Rivers is a non-profit cooperative corporation engaged in the generation, transmission, and sale for resale of electricity to its four member cooperatives: Green River, Henderson-Union, Jackson Purchase Electric Cooperative Corporation, and Meade County Rural Electric Cooperative Corporation. Big Rivers, through its member cooperatives, provides electric service to approximately 80,000 consumers in portions of 22 counties in western Kentucky. Approximately 75 percent of Big Rivers' system revenue is derived from its two largest customers, NSA and Alcan. Each operates an aluminum smelter and they are collectively referred to as the "Smelters." All other customers are collectively referred to as the "Rural Customers."

BACKGROUND

In 1987, the Commission initiated Case No. 9885¹ to investigate Big Rivers' wholesale electric rates. Big Rivers' financial problems were well publicized at that time. The Rural Electrification Administration ("REA") had cut off committed loan

¹ Case No. 9885, An Investigation of Big Rivers Electric Corporation's Rates for Wholesale Electric Service.

funds to Big Rivers and was prosecuting a foreclosure action in federal court; the new, relatively expensive Wilson Generating Plant was fully operational but revenues were insufficient to cover expenses; and although electric rates had not been increased since 1981, increased rates might seriously jeopardize the economic viability of the Smelters. After a review of these issues and others in Case No. 9885, the Commission issued an Order on August 10, 1987 granting approval to: a Financial Workout Plan among Big Rivers, the REA, and two New York banks; a ten year variable electric rate for the Smelters that rises and falls in concert with the market price of aluminum; and the first step of a three step rate increase that was incorporated into the Financial Workout Plan. The Commission deferred action on the second and third step rate increases, to be effective January 1, 1989 and January 1, 1991, respectively, until an investigation and hearing could be held contemporaneously with each step. The Commission ordered Big Rivers to file applications for approval of each subsequent rate step.

Big Rivers subsequently sought approval of a definitive Debt Restructuring Agreement, entered into with its major creditors, to implement the Financial Workout Plan approved in Case No. 9885. The Commission granted approval of the Debt Restructuring Agreement on July 1, 1988 in Case No. 10217.² The Debt

² Case No. 10217, Big Rivers Electric Corporation's Application For Approval of Restructuring Agreement and For Authority to Issue Notes or Other Evidences of Indebtedness Pursuant Thereto.

Restructuring Agreement also required Big Rivers to seek approval of the three step rate increase that was reviewed in Case No. 9885.

Big Rivers filed an application on June 30, 1988, in Case No. 10265,³ requesting Commission approval of the second step rate increase for electric sales for resale to all customers including the Smelters. After conducting an investigation and hearing, the Commission approved the second step rate increase by an Order dated December 21, 1988. In early 1990, the Commission approved a Settlement Agreement between Big Rivers and the Smelters which implements the third step rate increase on January 1, 1991 and ensures that the Smelters will pay, over the remaining term of the variable rate, at least as much revenue as was projected in Case No. 9885.

REVENUE ISSUES

Big Rivers' pending application seeks to increase the rates of the Rural Customers to the third step level incorporated into the Debt Restructuring Agreement, to increase the energy charge to recover increases in variable operating and maintenance expenses, to initiate a time-of-day ("T-O-D") rate for new industrial loads, and to modify the demand billing and ratcheted demand for the Rural Customers. The proposed third step rate increase would

³ Case No. 10265, Big Rivers Electric Corporation's Notice of Changes in Rates and Tariffs for Wholesale Electric Service.

change the monthly demand charge from \$8.80 per kilowatt ("KW") to \$10.15 per KW. Big Rivers has proposed and the Commission has accepted the 12-month period ending December 31, 1989 as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test year, the Commission has given full consideration to appropriate known and measurable changes.

Big Rivers' financial statements indicate that its financial health and integrity are still greatly intertwined with that of the Smelters. As the market price of aluminum stays high, the Smelters continue to pay higher electric rates and Big Rivers continues to receive higher than projected revenues. This, in turn, benefits all customers since under the terms of the Debt Restructuring Agreement, Big Rivers is able to retire its highest interest bearing debts first.

Irrespective of the monthly variable rate actually paid by the Smelters, the Settlement Agreement requires the Smelters' total payments under the variable rate to equal the level found reasonable by the Commission in Case No. 9885. Thus, the total Smelter revenue over the remaining term of the variable rate is known and determinable, although the timing of its collection is not known. As a consequence, Big Rivers is required by Generally Accepted Accounting Principles to record on its books as income only the revenue derived from the Smelters calculated at the average variable rate, rather than the actual variable rate.

To the extent that the actual variable rate exceeds the average variable rate, the excess revenue is credited to a balancing account until it is earned by Big Rivers. Similarly,

when the actual variable rate is less than the average variable rate, the shortfall is debited to the balancing account and must ultimately be paid by the Smelters. Notwithstanding this accounting requirement, Big Rivers is obligated under the terms of its Debt Restructuring Agreement to remit to its creditors all cash in excess of expenses and a \$10 million level of working capital. Consequently, this accounting treatment does not result in the accumulation of any cash at Big Rivers. If any interest is earned on cash receipts prior to payment of debt service, the interest is remitted to Big Rivers' creditors along with the cash receipts.

The Commission has carefully reviewed Big Rivers' historic financial exhibits, its pro forma adjustments, and its financial forecast. The historic financial exhibits reveal that on an income-earned basis, Big Rivers' equity was a negative \$29.4 million on December 31, 1989, and declined to a negative \$41.5 million by April 30, 1990. Similarly, its 1989 net margins of \$35.1 million declined to a negative \$12.1 million for the first four months of 1990.

The financial forecast is based on Big Rivers' assumptions that aluminum prices will be at the 62 cents per pound average incorporated into the variable rate and that significant levels of off-system power sales will materialize in the future. Regarding the future prices for aluminum, Big Rivers admitted that it was not qualified as an expert for purposes of forecasting such prices. In addition, recent history has made the Commission acutely aware that the price of this commodity is highly volatile

and not readily capable of being accurately forecasted. As to the assumptions for power sales, Big Rivers' revenue projections optimistically include an anticipated long-term capacity sale of 200 megawatts ("MW") off system starting in 1993. While Big Rivers is obligated under the Debt Restructuring Agreement to sell 200 MW off system, such optimistic revenue projections must be tempered by the knowledge that no sales have yet been consummated.

The AG's argument that the proposed rate increase is not needed lacks merit. The evidence clearly demonstrates that absent a \$10.15 per KW demand charge, Big Rivers' ability to avoid a default under the Debt Restructuring Agreement is solely dependent on future cash flows from off system power sales that have not been made and aluminum prices never falling below the 62 cents per pound average. However, future levels of off system power sales and future levels of aluminum prices are neither known nor measurable. In establishing fair, just, and reasonable rates based on an historic test year, the Commission cannot rely upon imputed revenue attributable to these two speculative events to negate a needed rate increase.

Contrary to the AG's position, the \$10.15 demand charge is not necessitated by the Smelters' Settlement Agreement. There has been no change in the Smelters' variable rate or their total monthly power bills as a result of the Settlement Agreement. What the Settlement Agreement does change is the Smelters' demand charge to \$10.15 as of January 1, 1991. To not similarly increase the Rural Customers' demand charge, despite the need for additional revenues, would produce an unreasonable rate preference

in favor of the Rural Customers and seriously jeopardize Big Rivers' ability to satisfy its debt service obligations under the Debt Restructuring Agreement.

Further, Big Rivers' proposed demand charge of \$10.15 per KW is substantially below its actual cost of service, which is \$12.567 per KW. This reduction in cost of service was the direct result of significant interest rate concessions granted by the REA and embodied in the Debt Restructuring Agreement. The savings that result from Big Rivers' demand charge being below cost of service have been flowed through to all customers in the form of lower electric rates. The proposed increase in the demand charge is clearly needed by Big Rivers to pay debt service in accordance with the terms of the Debt Restructuring Agreement and to ensure that an event of default does not occur. In addition, the proposed increase in the energy charge has been shown to be cost based and will allow Big Rivers to recover its adjusted test year operating and maintenance expenses.

TARIFF ISSUES

Time-of-Day Rate

Big Rivers proposed a T-O-D rate to encourage new or expanded industrial power usage during the off-peak hours beginning at 10:01 p.m. and ending at 6:00 a.m. The proposed T-O-D rate would allow a customer to shift its peak demand to Big Rivers' off-peak hours while being billed only for the demand imposed during Big Rivers' peak hours of 6:01 a.m. through 10:00 p.m. Energy provided from the capacity associated with the off-peak demand in

excess of the customer's billing demand would be billed at 125 percent of Big Rivers' tariffed energy rate.

NSA supported the T-O-D rate as an appropriate step in the development of a system-wide load management strategy. NSA stated that Big Rivers' proposal could lead to lower future costs by freeing up existing capacity which would make possible the deferral or avoidance of the need for new capacity.

The Commission is supportive of Big Rivers' T-O-D proposal and finds that it should be approved. The T-O-D rate will encourage off-peak power usage which should result in more efficient use of Big Rivers' generating capacity. More efficient use of existing capacity should reduce or defer the need for new generating facilities which results in lower long-term costs for all customers. In addition, the proposed energy markup results in a beneficial contribution to Big Rivers' fixed costs.

Billing Demand at Rural Delivery Points

Big Rivers proposed to change its billing demand at rural delivery points from a non-coincident 30-minute demand to a coincident 30-minute demand. Big Rivers also proposed a provision to limit the increase in ratcheted demands to 3 percent in any consecutive 12-month period. None of the intervenors opposed these proposals.

Big Rivers opines that these changes will result in increased stability in the measurement of peak demand and will protect customers from the wide fluctuations in demand caused by aberrant weather conditions. Big Rivers also contends that these proposals will eliminate the need for its distribution cooperatives to

control their billing demands by switching loads from one delivery point to another and will save Rural Customers between \$2 and \$2.5 million on an annual basis.

The Commission finds Big Rivers' arguments to be persuasive. The proposed changes to billing demand will be beneficial to Big Rivers, the member cooperatives, and the Rural Customers.

Commonwealth Aluminum - Special Contract

Commonwealth Aluminum generally opposed Big Rivers' requested rate increase and specifically opposed the increased demand charge. Commonwealth Aluminum argued that under the terms of its contract with Green River and given its present operating conditions, it would be adversely impacted by Big Rivers' proposed increase more than any other customer. Commonwealth Aluminum based this claim on the 40 MW minimum billing demand it is required to pay under its contract compared to its actual monthly demand of 32 MW.

Commonwealth Aluminum argued that its circumstances placed it in a unique situation deserving of special consideration similar to what Commonwealth Aluminum claimed the Smelters received under the Settlement Agreement. Commonwealth Aluminum proposed two alternatives for alleviating the adverse impact of Big Rivers' proposed increase: (1) maintain the current \$8.80 KW demand rate charged to Commonwealth Aluminum or (2) reduce Commonwealth Aluminum's minimum billing demand. Commonwealth Aluminum contends that either of these alternatives would result in its electric charges being consistent with those of Big Rivers' comparable contract customers.

Big Rivers' disputed each of the claims made by Commonwealth Aluminum and argued that the rates requested in this proceeding will result in uniform demand charges for all of Big Rivers' customers. Big Rivers contends that Commonwealth Aluminum's understanding of the Settlement Agreement is incorrect, that Commonwealth Aluminum will not be impacted more adversely than any other customer, and that Commonwealth Aluminum's proposal constitutes a request for preferential rate treatment.

Big Rivers noted that there are at least 20 industrial customers on the system who have signed long-term service contracts that impose minimum billing demands on the customers. Of those contract customers, at least five have recently experienced actual demands that were less than their contract minimum billing demands. Each of these customers, except for Commonwealth Aluminum, accepted these events as normal business risks. There is no evidence that Commonwealth Aluminum's service contract was induced by fraud or even misrepresentation. Rather, Commonwealth Aluminum admitted that it purchased the former Martin-Marietta facility knowing that the service contract existed and assuming the obligations of the contract. In addition, such minimum contract demand levels were relied upon by Big Rivers in forecasting the need for the Wilson Generating Plant.

Commonwealth Aluminum claims that the adverse impact of the proposed rate increase is demonstrated by its exhibit showing the cumulative percentage increases in its electric costs since 1979. The Commission finds this evidence to be unpersuasive for three reasons. First, the percentage increases shown on this exhibit

are overstated by reflecting a combination of increased rates and increased consumption levels. The actual rate increases for Commonwealth Aluminum during this time were below the rate of inflation. Second, each of the rate increases shown on the exhibit was preceded by an investigation and a hearing. In each instance, the rates were set at the level necessary to permit the recovery of all reasonable costs and expenses. Since none of those rate increases was set aside on appeal, they are not now subject to attack as being unreasonable. The issue in this case is not the reasonableness of rate increases over the past 12 years, but rather the reasonableness of a demand increase from \$8.80 per KW to \$10.15 per KW.

Third, the rate increases shown on this exhibit were borne by all customers, not just Commonwealth Aluminum. There is no evidence that Commonwealth Aluminum was ever charged rates that materially differed from those charged other customers of similar size. To the extent that Commonwealth Aluminum's cost per KW consumed exceeds the tariffed rate, this is due solely to Commonwealth Aluminum's decision to consume less power than its contracted for minimum.

Having contracted for a minimum billing demand of 40 MW, Commonwealth Aluminum is not now entitled to revise its contract simply because it has made a business decision to operate at a lower demand level. As Commonwealth Aluminum stated, it signed a long-term contract for a minimum of 40 MW, and a maximum of 60 MW, of capacity to guarantee it a reliable source of power. That reliable source of power does exist, and Big Rivers and Green

River are ready, willing, and able to satisfy the contract terms. Commonwealth Aluminum is getting exactly what it contracted for -- the availability of a reliable source of from 40 MW to 60 MW of capacity. Commonwealth Aluminum may at any time reassess its business plan and elect to consume more than 40 MW of capacity. In fact, less than one month prior to the filing of this case, Big Rivers was notified by Commonwealth Aluminum that its projected demand consumption would exceed 40 MW for every year from 1991 through 2009.

While Commonwealth Aluminum has asserted that the rate relief it now seeks is necessary because it can no longer remain competitive in the industry, the record is devoid of any evidence to support this claim. Commonwealth Aluminum presented no financial analysis of its own position or of the industry in which it operates.

Commonwealth Aluminum's understanding of the Settlement Agreement is flawed. The increase requested herein will result in the Rural Customers' demand rate being set at a \$10.15 per KW level which will be consistent with the demand rate approved for the Smelters under the Settlement Agreement. There is no credible evidence to demonstrate that the proposed rate increase disadvantages the Rural Customers or results in unfair rates for Commonwealth Aluminum or any customer group. The alternatives proposed by Commonwealth Aluminum would, however, result in preferential rate treatment for Commonwealth Aluminum, a result which would be unfair, unreasonable, and not supported by the evidence of record.

MANAGEMENT AUDIT

In response to Commission information requests, Big Rivers provided certain information relating to the management audit. At the public hearing, Big Rivers provided additional information relating to its activities to implement specific recommendations of the management audit.

The Commission is encouraged by the information provided which indicates that Big Rivers will act in a prompt and efficient manner to implement the recommendations of the audit. The Commission will continue to monitor Big Rivers' implementation activities through the normal management audit follow-up process and encourages Big Rivers to continue to pursue these recommendations and other activities which may reduce Big Rivers' cost of service.

SUMMARY OR FINDINGS

1. Big Rivers' proposed rates, set forth in Appendix A, attached hereto and incorporated herein, are fair, just, and reasonable in that they will produce sufficient revenue to pay all reasonable expenses and satisfy the debt service requirements set forth in the Debt Restructuring Agreement.

2. Big Rivers proposed T-O-D rate, and modification of billing demand for rural delivery points to utilize a non-coincident demand and a 3 percent maximum increase on ratcheted demands, are reasonable and should be approved.

3. Commonwealth Aluminum's proposed alternative rate treatment would result in an unreasonable rate preference and should be denied.

IT IS THEREFORE ORDERED that:

1. Big Rivers' proposed rates, set forth in Appendix A, be and they hereby are approved for service rendered on and after January 1, 1991.

2. Within 30 days of the date of this Order, Big Rivers shall file its revised tariffs setting forth the rates and tariff changes approved herein.

Done at Frankfort, Kentucky, this 21st day of December, 1990.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-128 DATED 12/21/90

The following rates and charges are prescribed for Big Rivers Electric Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

RATES:

For all non-smelter delivery points:

- (1) A Demand Charge of:
All KW of billing demand at \$10.15 per KW.

Plus,

- (2) An Energy Charge of:
All KWH per month at \$0.181506 per KWH.